What's New in Cybertalk?

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Ebix.com: Facing Considerable Challenges

In November 1999, CyberTalk reported on the Internet auction phenomenon, with a particular emphasis on Ebix.com, an insurance auction site that began operation in September 1999. Since that time, Ebix.com has won much favorable comment in the press. For example, it was listed in *Forbes*' "Best of the Web" issue (September 11, 2000). It also has established numerous alliances with other Internet sites and persuaded a host of established insurance companies to quote prices on the site. Unfortunately, however, it has also failed to attract a large number of insurance applicants, suffered grave financial problems, and faced SEC challenges to some of its accounting practices. This issue of CyberTalk explores the multiple dimensions of Ebix.com's experience over the past year.

Why do these multiple dimensions deserve exploration? The biggest issue facing anyone who attempts to judge the penetration of new Internet business models is discovering what is real. Internet companies are extremely skilled at presenting compelling accounts of their activities. If their sites look good and appear easy to use, the press likes them. Good press may even translate into high stock prices. The company's financial statements, presuming they are honest, may provide a better indicator of what the market of insurance buyers—not the stock market—really thinks of the business model. If the business model is not yet generating much revenue, insurance buyers are not yet widely using it. They may do so in the future. It is important for the insurance industry to understand what is real right now.

Ebix.com's Beginnings
Ebix.com began operation in 1976 as Delphi Information Systems, a supplier of agency management software primarily to the property & casualty industry. By the late 1990s, this business was in decline, but the Internet was growing. Management decided to switch the company's focus to the Internet.

As reported previously, Ebix.com operates an insurance auction mall called Ebix.mall. It uses the reverse auction model popularized by Priceline. The prospective buyer selects the type of insurance he wishes to buy and enters personal details in an online application in ACORD format. In addition, he can also enter the amount of the monthly premium he wishes to pay. Agents, brokers, and insurers are invited to make offers on this business. Both prospective buyers and sellers can see summary personal details of all potential buyers and the high and low offers all sellers have made for the buyers' business. Potential buyers can enter a future time—between one and three days—at which the auction of their business will end. Any licensed agent, broker, or insurer can register with Ebix.mall and make offers. The site is free to prospective insurance buyers. Sellers pay a $100 annual registration fee. If an agent/carrier provides a quote, the agency/carrier is charged $1.00. If the consumer decides to make the purchase, the agent/carrier is charged another $20. The two transaction fees are now double what they were one year ago. In February 2000, Ebix.com reported attracting 85,000 visits per month.

In August 2000, Ebix.com reported that over 1,000 agents and 30 carriers had registered to quote prices on Ebix.mall. Insurers offering price quotes through Ebix.mall—either directly or through agents—include The Hartford, Principal Financial Group, CNA, Electric Insurance, Golden Rule Insurance, SBLI Mutual Life of New York, Midland Life, Western Southern Life, Amica Life, and others.

Building Alliances
Ebix.com is currently assiduously building alliances with other Web sites in order to generate traffic. As of July 2000, it claimed to have negotiated 65 alliances during the preceding three months alone. As part of the alliances, the Ebix.com partner builds an insurance center, with a prominent link to Ebix.com's site. The alliances typically involve revenue sharing, with the partner receiving a share of the fee Ebix.com receives for leads generated through the partner site, in addition to a fee when a lead converts into an actual sale.

Alliances recently announced by Ebix.com include the following partners and many others:

- FinancialWeb, a financial aggregator
- Women's Health Interactive
- Autoparts.com, an auction site for do-it-yourself auto enthusiasts
- Money-Rates.com
- ComCorner.com, a classified commerce site for businesses
- Eyesearch.com, an online eye care and vision site
- Afronet.com, an African American portal
- The Dollar Stretcher (www.stretcher.com), a frugality site
- Stockz.com, a provider of market data
- RentConnection.com, a home rental search service
- Nadaguides.com, a publisher of used vehicle values
- SimplyHealth.com
- Med411.com, a search engine for the medical community
- 1SourceAutoWarranty.com, a provider of extended warranty coverage for vehicles

In establishing alliances with other sites, Ebix.com is following a path paved by numerous others on the Internet.

Applicant Volume
After one year in operation, Ebix.mall is still not generating a high volume of insurance applicants. Because users of the mall can see the number of applicants for insurance at any particular time, it is easy to determine traffic levels. Figure 1 shows how the number of insurance applicants on Ebix.mall on September 6, 2000, compares to the number recorded in the course of a visit to the site on October 25, 1999.

At least one applicant for health insurance in September 2000 received bids from eight different insurers or agents/brokers. Most applicants appear to have received only one or two bids. Although traffic on the site is clearly increasing, particularly in the case of auto insurance, it is far from enough to generate significant revenue.

Financing A Transformation
Because Ebix.com was already a publicly traded company before its metamorphosis into an Internet company, it was not in a position to offer an IPO and benefit from a big, new infusion of cash from investors. Thus, it did not have the grace period that many Internet start-ups have had, during which they could spend IPO money freely and not worry about whether they could meet payrolls.

Ebix.com appears to have financed its transformation into an Internet company by issuing warrants to Hewlett-Packard, and InfoSpace (*see sidebar*). Warrants are, in effect, long-term options that allow investors to buy the company's common stock for a specific price for a specific length of time. Warrants can be traded, with their price reflecting the price of the underlying stock. If the stock price drops below the prices specified in the warrants, the warrants lose their value. Presumably, Hewlett-Packard and InfoSpace accepted the warrants in lieu of fees for products or services. Hewlett-Packard is a major computer manufacturer. InfoSpace is a provider of infrastructure services for Web sites, merchants, and wireless devices. The warrants granted to Hewlett-Packard and InfoSpace were priced at $15 per share during the first year and $20 per share during the second year. The earliest of these warrants was issued in 1999. The value of Ebix.com stock peaked in March 2000 at about $14 per share. It now trades at between $4 and $5 per share.

The company also issued stock options to key executives, selected employees, and selected outside investors.

In January 2000, Ebix.com announced that shareholders had exercised all company warrants set to expire

January 17, 2000, for a total of 1,126,100 shares. The price of the warrants was close to $8.5 million, or about $7.50 per share, below the $10-11 per share the stock was trading at the time. The warrant holders apparently made a decision to provide additional financial support to the company, despite the failure of the company's stock to rise above $14 per share. Ebix.com indicated that exercised warrants brought the firm's cash total to over $10 million and eliminated its outstanding debts.

Ebix.com and the SEC

Publicly traded companies such as Ebix.com want their stock to trade at high prices. Because investors base their investment decisions in part on the company's finances, the U.S. Securities and Exchange Commission (SEC) requires that publicly trading companies follow certain rules for disclosing financial information. The SEC wants to prevent companies from inflating their financial results in order to boost their stock prices.

Early in 2000, the SEC's Division of Corporation Finance questioned the way that Ebix.com had recognized revenue in conjunction with software licenses. Ebix.com asked accounting firm Arthur Andersen LLP to re-audit its finances. Andersen advised Ebix.com to reverse almost $260,000 of 1998 revenues from Canadian contracts and began examining whether revenues from other software contracts should also be reversed. It also looked at how Ebix.com capitalized software expenses and classified certain receipts.

On March 31, 2000, Ebix.com announced that it was unable to file its SEC Form 10-K reporting its financial results for the year ending December 31, 1999, as required by law, because of the Andersen re-audit. It applied for a 15-day extension of its 10K filing. Arthur Andersen did not complete the re-audit within the 15-day extension period. The NASDAQ Stock Market, on which Ebix.com stock trades, moved to de-list the stock.

On April 26, Ebix.com appealed the decision. On May 16, it announced that it was unable to file its Form 10-Q reporting its results for the first quarter of 2000, as required by law, because of the re-audit. At that time it indicated that the re-audit was addressing events that took place as early as 1997. On June 1, 2000, the NASDAQ Listing Qualification Panel heard Ebix.com's appeal. On the same day, the company also made a late filing of its 1999 Form 10-K. On June 15, 2000, it made a late filing of its Form 10-Q covering the first quarter of 2000. Because of these moves, the NASDAQ Stock Market permitted Ebix.com to continue to be listed.

On August 15, the company filed Form 10-Q covering unaudited results for the second quarter and six months ending June 30, 2000. This filing occurred on time. In it, the company reported that it had experienced a negative operating cash flow of $4.8 million and operating losses during the first six months of 2000. It stated that although transactions occurred on its Web site in 1999 and 2000, the company did not process the charges, which were "de minimis" in amount. It, therefore, did not recognize any revenue from the site. The company reported that it lacked the capital to promote its Web site adequately. It also indicated that in order to meet the projected cash requirements of its business and remain a going concern after the next 12 months, it will have to find new sources of revenue or financing.

Problems and Challenges

Between the first six months of 1999 and the first six months of 2000, the company's total revenue decreased 20.8 percent. Its total software revenue decreased 23.9 percent, an indication that its Web products had not yet begun to generate new revenue to replace declining revenue from its agency management legacy products.

But Ebix.com's problems were not over. In August, it also reported that it had been advised that the Securities and Exchange Commission had issued a formal order of investigation and subpoenaed documents relating to the company's financial reporting since April 1, 1997. The investigation and subpoena includes in particular revenue recognition, software development cost capitalization, royalty costs, and classification of cash receipts which were affected by the restatement of earnings.

Thus, Ebix.com will face considerable challenges in the months ahead. Its management can take heart from the fact that a lot of recent Internet IPOs with equally interesting business models will face similar challenges—generating enough revenue from real customers to remain viable.

Figure 1: Comparison of Number of Insurance Applicants on Ebix.mall (return to article)

Type of Insurance	October 1999	September 2000
Auto	57	174
Life	18	24
Homeowners	18	36
Health	34	32

Sidebar: Summary of Warrants Issued by Ebix.com

In August 1999, Ebix.com granted Hewlett-Packard a two-year warrant to buy 4.9 percent of the company's outstanding stock for $15 per share during the first year of the warrant and $20 per share during the second year. It also granted a second warrant to Hewlett-Packard under the same agreement for the purchase of 4.5 percent of the company's outstanding common stock during the second year of the term of the agreement for $20 per share. On June 30,2000, the warrants issued to Hewlett-Packard represented the rights to purchase more than 1,000,000 shares.

The company also issued warrants to InfoSpace.com. The first warrant was for the purchase of 250,000 shares of the company's common stock at a price of $15 per share if exercised during the first year of the agreement or $20 per share if exercised during the second year of the agreement. The warrants vested 62,500 shares on September 30, 1999; 62,500 shares on December 31, 1999; and 125,000 shares on March 31, 2000. The company granted a second warrant to InfoSpace.com for the purchase of 4.9 percent of the company's outstanding common stock. It represents the right to purchase 526,572 shares at a price of $15 per share if exercised during the first year of the agreement or $20 per share if exercised during the second year of the agreement. The second warrant is exercisable in lieu of the company paying invoices rendered by InfoSpace.com. (return to article)